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SIPDIS

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STATE FOR NEA/ELA; COMMERCE FOR
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SUBJECT: BUDGET DEFICIT THREATENS SYRIA'S ECONOMIC GROWTH

SUMMARY

¶1. The 2008 Syrian budget typifies the lack of SARG transparency by significantly underreporting petroleum revenues, defense expenditures, and the cost of subsidies. Even though the official numbers are suspect, local economists agree that the SARG's acknowledgement of a 128-percent increase in the budget deficit is a significant indicator of Syria's true economic health. Also likely to be underestimated, the reported USD 3.85 billion deficit represents nearly 10 percent of Syria's estimated 2008 GDP. SARG officials attribute the increased deficit primarily to petroleum-related circumstances. Syria's oil revenues are projected to decline proportionately with decreased production, while high oil prices mean that Syria will be paying more for imported refined petroleum by-products, such as diesel. Since publishing the budget, the SARG has announced various measures under consideration to increase revenues, such as re-writing corporate tax codes, issuing Treasury bills, and implementing a VAT in 2009. Ultimately, economists say, the SARG must also cut costs by lowering all fuel subsidies or risk severe inflation and currency devaluation. End summary.

BUDGET DEFICIT INCREASES BY 128 PERCENT

¶2. The 2008 SARG budget forecasts an unprecedented deficit of USD 3.85 billion, a 128 percent increase from 2007. This deficit represents 9.8 percent of the estimated Syrian GDP of USD 39.1 billion. In keeping with past practices, the SARG stated that it will cover USD 3.63 billion of the deficit by drawing on Central Bank reserve funds and finance the remaining USD 213 million through external loans and Treasury bills. Syrian economists worry that such a large deficit cannot be sustained without driving up inflation -- already officially estimated at 8.9 percent -- and retarding Syria's projected GDP growth of 4.5 percent in 2008.

SUBSIDIES AND DECLINING OIL REVENUES TO BLAME

13. Economic reformers point to government fuel subsidies as the primary reason behind the ballooning deficit. As Syria transitioned to become a net-importer of refined petroleum products in 2006, the SARG faced not only higher market prices for fuel but also significantly increased public demand. While the 2008 budget allocates only USD 500 million for all "price controls," the quasi-independent business journal Al-Iqtisadiyah estimated the price of diesel subsidies alone at USD 3.76 billion for 2008. Similarly, at the end of 2007 Finance Minister Muhammad al-Hussein told local media that the total cost of all subsidies would amount to USD 7.14 billion in 2008, or roughly 18 percent of GDP.

14. The 2008 budget also projects that total revenues will decrease by 19 percent from 2007 to USD 8.15 billion, with oil export revenues of approximately USD 2 billion providing 24.6 percent of the total. Oil revenue calculations assume a price of USD 42 per barrel for heavy crude and USD 51 per barrel for light crude, so actual revenues are likely to be doubled if the price of oil remains in the USD 90-100 range. Additionally, the budget assumes Syrian oil production will fall to just 360,000 barrels per day (bpd) in 2008, almost evenly divided between heavy and light crude oil.

SEEKING TO INCREASE REVENUES, CUT COSTS

15. While the internal debate over cutting diesel subsidies continues, the SARG had already enacted some measures to reduce costs and increase revenues by late 2007. On September 1, the government raised the price of electricity by a scaled-average of 34 percent. In November, the SARG also increased the prices of gasoline and water, by 20 percent and 37 percent, respectively. Over the same period, President Asad issued a decree to issue Treasury Bills in 2008 to partially finance the deficit. Consultants say that additional steps under consideration are aimed at increasing tax collection. They argue that the Syrian private sector is responsible for 67 percent of GDP, but contributes a disproportionately low percentage of tax revenues. In addition to modifying the corporate tax laws to better capture lost revenues, the government also plans to implement a Value-Added Tax (VAT) in 2009.

THE "OFFICIAL" NUMBERS

16. According to the published budget, the SARG allocation by ministry is as follows:

Ministry	Millions USD	Percentage
Defense	1,445	12
Interior	289	2.4
Foreign Affairs	103	0.9
Information	80	0.7
Immigration	1.2	0.0
Higher Education	464	3.9
Education	801	6.7
Culture	37	0.3
Labor/Social Affairs	22	0.2
Health	140	1.2
Economy	11	0.1
Finance	2,444	20.4
Agriculture	383	3.2
Irrigation	129	1.1
Petroleum	314	2.6
Industry	153	1.3
Electricity	541	4.5
Water	151	1.2
Building	18	0.1
Tourism	25	0.2
Trade	31	0.2
Telecommunications	185	1.5

Transportation	272	2.3
Grain Storage	70	0.5
Presidency	32	0.3
Parliament	10	0.1
Prime Ministry	151	1.3
Justice	38	0.3
Housing	103	0.1
Local Admin/Envinronment	1,284	10.7
Governorates	593	4.9
Waqf	7.6	0.0

Investment Capital / for Private Sector	20	0.2
Price Stabilization (subsidies)	500	4.0
Reserve Credits for Investment Projects	940	8.0

17. 2007-2008 BUDGET COMPARISONS (Millions of USD)

	2007	2008	Percent Chg
Revenues:			
Taxes and duties	4,052	4,385	8.2
Fees and royalties (oil)	942	932	-1
Contributions of State enterprises (Surplus and depreciation)	4,795	1,986	-58.6
Other income	284	852	200
Total	10,073	8,155	-19
Expenditures:			
Total	11,760	12,000	2
-Current	6,600	7,400	12
-Capital	5,160	4,600	-11
External grants and loans tied to projects			
-Under capital expenditure	1,686	3,844	128
"Financing Gap"	359	213	-41
External "Arab" financing	0	0	0
Central Bank borrowing	1,327	3,631	173

18. FUNCTIONAL BREAKDOWN OF EXPENSES (Millions of USD)

	2007	2008	Percent Chg
Current	6,600	7,400	12
Chapter I - Salaries	2,013	2,283	13
Chapter II - Admin	470	528	12
Chapter IV - Transfers	675	719	6
Chapter V - Pensions	1,535	1,882	22
Defense	1,369	1,445	5.5
Presidency/parliament	37	42	14
Chapter III - Capital	5,160	4,600	-11
Total	11,760	12,000	2

19. BREAKDOWN OF INCOME SOURCES (Millions of USD)

	2007	2008	Percent Chg
Direct Taxes	3,365	3,525	5
- Businesses	2,500	2,390	-4.4
- Salaries	126	140	11
Indirect Taxes	687	856	24
- Electricity Consumption	36.4	42	15
- Customs	320	460	44
- Stamps	174	192	10
- Fees	34	42	23
Total taxes and duties	4,052	4,385	8
Services and royalties	942	932	-1.0
- Oil royalties	882	849	-3.7
Contribution of state enterprises (surplus)	4,795	1,986	-58.6
- Extraction industries	2,639	21.6	-99
- Banks and finance	451	715.5	58
- Converting industries	304	186	-39
- Transportation and Communications	779	809	4

- Electricity, gas, water	249	2	-99
Other income	284	852	200
Total revenues	10,073	8,155	-19
Revenue deficit	1,686	3,844	128
Financed by:			
External loans / grants	359	213	-41
Central Bank borrowing	1,327	3,631	173
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